No. 10171.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

ELIZABETH H. FISHER,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition for Review of the Decision of the United States Board of Tax Appeals.

BRIEF FOR PETITIONER.

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BRIEF FOR PETITIONER.

Opinion Below.

The only previous opinion in this case is that of the Board of Tax Appeals [R. 25-37], which is not yet reported.

Jurisdiction.

The petition for review [R. 52-55], involves a deficiency in gift tax for the year 1937 in the amount of $2,283.28 [R. 37], and is taken from a decision of the Board of Tax Appeals, entered February 18, 1942. [R. 37.] The petition for review was filed May 8, 1942 [R. 56], pursuant to the provisions of Sections 1141-1142 of the Internal Revenue Code.

Questions Presented.

There are two questions presented.

First question:

Where an irrevocable gift of property is made in the year 1937 by a donor to her six, named grandchildren, to be held in trust for their sole benefit until each donee grandchild attains the age of twenty-five years, during which time the full net income of the trust is to be distributed equally among the beneficiaries, and upon each donee reaching the age of twenty-five years,, his pro-rata share of the property is to be distributed to him free of the trust, or, if not living, to his issue, or otherwise, among the remaining donees, is such a gift a present interest in property to the donees, or a future interest in property for purposes of gift tax exclusion? The Board of Tax Appeals held that the rights of the donees to receive the income until attaining the age of twenty-five years were present interests in property, while "the gifts of the remainder interests, that is, the corpus of the trust, were gifts of future interests." [R. 36.]

Second question:

If the gift described above has a dual character, to-wit, both a present and future interest in property for gift tax exclusion purposes, is the proper period of time by which to value the right to receive the income from the property the life-spans of the donees, since each donee will under the gift receive such income from the property while it is in trust, and also for the rest of his life while the property is out of the trust? The Board of Tax Appeals held that the value of the right to receive the income was to be determined solely by the period while the property was in trust.

Statutes and Regulations Involved.

Revenue Act of 1932, 47 Stat. 169, ch. 209:

"Sec. 504. Net Gifts.

* * *

(b) Gifts Less Than $5,000.—In the case of gifts (other than of future interests in property) made to any person by the donor during the calendar year, the first $5,000 of such gifts to such person shall not, for the purposes of subsection (a), be included in the total amount of gifts made during such year."

Regulations 79 (1936 Edition):

"Art. 10. Total Amount of Gifts.—In determining the amount of gifts during any calendar year, there is excluded (save in the case of a gift or gifts of a future interest or interests) the first $5,000 of any single gift or aggregate of gifts made during such year to any one donee. A gift or gifts made during a given calendar year to any one donee of $5,000, or less, should not be listed on the return, unless consisting of a future interest or interests, or unless consisting of a present interest or interests created out of the same property in which a future interest or interests has been given. Gifts of future interests in property are required to be included in the total amount of gifts for the year even though the value of such gifts is $5,000, or less, and if such interest exceeds $5,000 in value, no part of the value is excluded from the total amount of gifts for the year whether the gift or gifts to be a single donee or to a number of donees. For example, if the donor during the calendar year made a gift to A of $5,000 in money, a gift to B of $6,000 in money, and a gift to

C of a future interest in property, such future interest being valued at $3,000, the total amount of gifts during such year, for the purposes of the tax, is $4,000.

"ART. 11. FUTURE INTERESTS IN PROPERTY.—No part of the value of a gift of a future interest may be excluded in determining the total amount of gifts made during the calendar year. 'Future interests' is a legal term, and includes reversions, remainders, and other interests or estates, whether vested or contingent, and whether or not supported by a particular interest or estate, which are limited to commence in use, possession, or enjoyment at some future date or time. The term has no reference to such contractual rights as exist in a bond, note (though bearing no interest until maturity). or in a policy of life insurance, the obligations of which are to be discharged by payment in the future. But a future interest or interests in such contractual obligations may be created by the limitations contained in a trust or other instrument of transfer employed in effecting a gift. For the valuation of future interests, see subdivision (7) of article 19."

Statement.

This appeal is solely upon the conclusions of law reached by the Board of Tax Appeals.

The controversy involved in this review concerns the petitioner's gift taxes for the year 1937. In that year, petitioner, a grandmother, transferred irrevocably income securities, having a value of $29,662.49 [R. 43], in trust to her six, named grandchildren, with provision that the income from the securities, after paying taxes and necessary trust expenses, be distributed annually among the six

donees until each reached the age of twenty-five years. Upon attaining that age each donee took his share of the property free of the trust, or if not living such share went to his issue, or if not living and without issue, such share went to the remaining donees. [R. 44.]

The contestants stipulated to the facts found by the Board pertaining to the gifts [R. 42-52], with the exception of the finding that "the principal distinction between the instant case and the *Pelzer* case is that here the distribution of the trust income to the donees was to commence immediately within the year of the creation of the trust, rather than ten years later, as in the *Pelzer* case." [R. 34.]

The petitioner herein duly filed her gift tax return for the year 1937, reporting the gift of property in trust to her six named grandchildren. She took in said return in respect to such gift an exclusion from gift taxation of not exceeding $5000.00 for each of the six named donees.

The Commissioner of Internal Revenue subsequently levied a deficiency in respect to the donor's gift tax, allowing her but one exclusion from gift taxation of $5000.00. He took the position that petitioner's gift in the year 1937 was to the trust as a donee entity, and not to the six named grandchildren as donees.

The original proceeding before the Board in respect to this gift was brought on the alleged error of the Commissioner in holding that the gift was to the trust and not to the individual donees. The Board decided this issue in favor of the petitioner March 15, 1941, upon the authority of *Commissioner v. Hutchings,* 312 U.S. 393 (decided March 3, 1941.) [R. 25.]

Thereafter the respondent Commissioner filed a motion before the Board to set aside the Board's opinion of

March 15, 1941. The Commissioner alleged for the first time in said motion that the petitioner's gift of 1937 was in the nature of a future interest in property, to-wit, "it will be seen from the foregoing that the beneficaries' possession and enjoyment of both income and principal were dependent upon future contingencies." [R. 40.]

Thereafter, the Board ordered that its opinion of March 15, 1941, be set aside, and that the proceeding be restored to the general calendar for hearing.

In the ensuing proceeding before the Board, the petitioner argued that the income from the property was to be distributed to the donees currently under the trust, which constituted the necessary element of present enjoyment of the gift to make the gift a present interest in property to the donees for purposes of gift tax exclusion.

The Board, in its decision rendered February 18, 1942, found as a matter of fact that the income from the property during the trust was to be distributed at least annually among the donees. [R. 34.] It nevertheless held that the same gift to the same donee was in part a present and in part a future interest in property, to-wit, a present interest in property to the extent the donee would receive income from the trust, and a future interest to the extent of the same donees' right to receive the corpus. It thus answered neither the prayer of the respondent nor of the petitioner in full. In sole support of its conclusion by way of precedent the Board cited its own rulings in three recently decided cases. Oddly, if not significantly, neither respondent nor petitioner had cited these cases to the Board in argument. The rulings of the Board in these cases are novel and have not been heretofore reviewed by the Courts.

Specification of Errors.

Petitioner relies on all the points contained in his statement heretofore filed [R. 58-59], to-wit:

"1. The Board of Tax Appeals erred in concluding that any part of petitioner's irrevocable gifts of property in trust, in the year 1937 to her six named living grandchildren were gifts of future interests in property where under the terms of the trust each donee beneficiary was entitled to the enjoyment of the current income of the property in trust until he reached the age of twenty-five years, and thereupon to receive his pro-rata share of the property in trust, if living, or if not living, but with issue, to have such property in trust distributed among his issue.

"2. In the alternative The Board of Tax Appeals erred, after concluding that the rights of the donees to receive the current income from the property were present interests in property, in not valuing such present interests upon a period of the life expectancies of the six named living donees, since the donees would always receive such income if living, to-wit, from the trust until they attained the age of twenty-five, and directly from the property thereafter for the rest of their natural lives.

"3. The Board of Tax Appeals erred in holding that there was a deficiency of gift tax due from petitioner for the year 1937 in the sum of $2283.28, or any other sum, by reason of petitioner's gifts in the year 1937 being gifts of 'remainder interests' or 'future interests'."

Summary of Argument.

On the first question presented in this appeal as set forth herein, and as contained in the first specification of error, petitioner argues that to constitute a present interest in property for the purpose of gift tax exclusion it is only necessary that the donee receive the full enjoyment of the gift in the form in which the gift is given. It is not necessary for such purpose for the donee to have the immediate power to destroy the gift and defeat the beneficent purpose of the donor, in addition to receiving the full enjoyment of the proceeds of the gift. The Board of Tax Appeals applies the statute involved in the latter sense. Such a severe application of the statute is not supported by the decisions of the Courts.

On the second question presented, and as contained in the second specification of error, and in the *alternative,* petitioner argues that if in fact a gift of property to a donee will make him a life beneficiary of the income thereof, such fact should control in the appraisal of his right to receive such income from the property for the purposes of gift tax exclusion. The appraisal of the donees' right to receive income from the gift should not be controlled by a mere temporary form in which the property is conveyed to the donee, such as a temporary custody in trust for the donee's benefit, when the certain and ultimate

form is absolute ownership of the income from the property for the life of the donee.

The appraisal of the donees' present interest in the property by the Board of Tax Appeals in the instant case is based on mere form. The appraisal by the Board assumes that the donees will all die at the age of twenty-five, to-wit, when the temporary custodianship of the property by the trustee terminates, and therefore they will not receive the income thereafter. Either this, or it assumes someone else than the named donees will receive the income after they are twenty-five years of age. Such latter assumption is contrary to fact where the same donees receive after they are twenty-five years of age as received before they are twenty-five years of age. The appraisal formula of the Board disregards the fact, substance and reality of the property interests acquired by these donees from the donor.

ARGUMENT.

I.

The Donees Received a Present Interest in Property Entirely.

Plainly the statute relating to taxation of gifts during the years 1932 to 1938 permitted donors to exclude annually from gift taxation an amount up to the first $5000.00 given to each donee. (Sec. 504 (b), Revenue Act of 1932.) The evident purpose of Congress in this legislation was to encourage a broad distribution of wealth in the nation at that time by means of numerous small gifts. This distribution of wealth could not be effected by the transfer from donors to donees of a mere future interest in the property transferred, to-wit, an interest which was to commence in use, possession, or enjoyment at some future date. Accordingly, Congress limited the exclusion from gift taxation to be enjoyed by donors to gifts of present interests in property.

In the instant case the donor, a grandmother, divested herself in the year 1937, irrevocably of property, securities, having a substantial income, in order that her six named grandchildren might immediately have the enjoyment of such income. "* * * assuring as far as possible to the beneficiaries herein named the beneficial use of the income therefrom until this trust as herein provided terminates as to him or her and the preservation of the principal for distribution to him or her at the time herein provided for and otherwise for his or her general welfare." [R. 45.]

Because of the tender age of the six named donees, and their consequent inability to act competently, the donor placed the property in the temporary custody of her adult son as trustee, with adequate provision in the trust

for current distribution of all the income to the donees, and delivery of an aliquot share of the property creating the income to each donee grandchild when he attained the age of twenty-five years, this age being, in the donor's opinion, a time in the donee's life when he could protect his estate. In the event a donee died before reaching the age of twenty-five, the donor provided that his share of the property should go to his estate if he had descendants (issues), otherwise, such share should vest in the remaining donees. The donor was plainly motivated by the desire to transfer forever and exclusively the gift property and all the benefits of the ownership thereof to the six named donees. The trust was not intended by her to be a limiting device, and an end in itself, but merely a temporary custodianship or vehicle by which the securities would become the property of the six minor donees for the rest of their lives, and her beneficent purpose accomplished effectively.

The question in the instant case is: Did the gift of the donor amount to a present interest in property to the donees?

Several standards for the determination of the above question have been established by the decisions of the Courts and the Board of Tax Appeals, statutes, Congressional reports and text-books, and are discussed herewith.

The United States Supreme Court decided the case of *U. S. v. Arthur Pelzer,* 312 U. S. 399, March 3, 1941, which related to a donor's right to exclusion from gift taxes. Therein, in the year 1937, the donor conveyed property in trust for the benefit of living and after-born grandchildren, with a provision that the income of the trust would be accumulated in the trust for ten years from the creation of the trust. In its decision in the instant

case, the Board makes substantial reference to the *Pelzer* case, and therefore your petitioner will likewise discuss the facts and opinion of the *Pelzer* case (*supra*), by way of comparison with the gift of petitioner.

1. **The Income Tax Laws Set a Simple Standard for Determining Whether Donee Beneficiaries Have a Present Interest in Trust Property.**

Under *Sec. 162(b) of the Revenue Act of 1936,*[1] pertaining to income taxation, the donees of the gift in the instant case were chargeable with the income therefrom immediately after the gift. Such section provides in effect that if a trustee is required under the trust to distribute the income thereof annually among the beneficiaries, such income is reportable by the beneficiaries and not by the trustee. It is well recognized among tax students that the gift tax laws and income tax laws are of a complimentary nature. Unless the beneficial ownership of property has completely shifted from donor to donee, the donee is not chargeable with the income therefrom. In such a negative transfer, either the donor or the trustee is chargeable with the income tax on the income from the property. In the instant case, neither the trustee as a mere temporary custodian of the property, nor the donor, was chargeable with the income from the property after the gift, for the purposes of income taxes. Had the trustee been permitted to accumulate income in the trust, the trustee would have been chargeable with the income for income taxes. In

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[1] "(b) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income * * * which is to be distributed currently by the fiduciary to the beneficiaries, * * *, but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. * * *"

the instant case the donees were immediately chargeable with the income for income tax purposes. It seems axiomatic that a person charged with ownership of the present interest in property for income tax purposes should also be credited with the ownership of the present interest for gift tax purposes.

It is notable that, while not applied by the Court in the *Pelzer* case (*supra*), nevertheless, the beneficial interests created by the gifts in the Pelzer trust did not meet this test as to the ownership of the present interest by the donees. There the trustee is chargeable with the income tax on the income, since he was directed to accumulate the income for ten years. In that case, the Supreme Court held the gifts to be future interests in property. Applying this test, however, in the instant case (which was suggested by petitioner in argument before the Board), the Board should have concluded that the donees received a present interest in property exclusively.

2. The Reports of the Congressional Committee, in Creating Section 504(b), Set Another Simple Standard Frequently Referred to by the Courts.

An oft-quoted standard for determining the meaning of the term "future interests" in property for purposes of gift tax exclusion is the Committee report recommending the legislation pertaining to gift tax exclusion. (H. Rept. No. 708, 72d Cong., 1st Sess., p. 29; S. Rept. No. 665, 72d Cong., 1st Sess., p. 41.)

> "The term 'future interests in property' refers to any interest or estate, whether vested or contingent, limited to commence in possession or enjoyment at a future date. The exemption being available only in so far as the donees are ascertainable, the denial of

> the exemption in the case of gifts of future interests is dictated by the apprehended difficulty, in many instances, of determining the number of eventual donees and the values of their respective gifts."

Stripped to bare essentials under this standard, a present interest in property for gift tax exclusion purposes must:

(a) Commence in possession or enjoyment immediately;

(b) The donees must be ascertainable.

The gifts in the present case commence in enjoyment immediately. The donor ceased to enjoy and the donees commenced to enjoy the property simultaneously when the donor transferred the property. It was as if the donor moved out of the house and the donees moved in to enjoy the property in the form in which the donor enjoyed it. It was a normal enjoyment, exactly the enjoyment the donor would have continued to have, had she retained the property.

The donees were ascertainable since they were named and living persons. The values of their respective gifts were determinable by dividing the value of the donated property by six (the number of named donees). The named persons were the exclusive donees under the gift. No other donees could take the gift. [R. 47.]

It was on the standard set by the Congressional Committee Report that the donees' interests in the *Pelzer* trust (*supra*), failed to qualify as gifts of present interests in property. There the court was troubled with the fact that the income from the gift property had to be accumulated by the trustee for ten years after the gift. Further, the donees included, besides named grandchildren of the donor,

all after-born grandchildren. In this dilemma the court said (*U. S. v. Pelzer*, 312 U. S. 399, p. 404):

> "Here the beneficiaries had no right to the present enjoyment of the corpus or of the income and unless they survive the ten-year period they will never receive any part of either. The 'use, possession or enjoyment' of each donee is thus postponed to the happening of a future uncertain event. The gift thus involved the difficulties of determining the 'number of eventual donees and the value of their respective gifts' which it was the purpose of the statute to avoid."

The above difficulties do not exist in the instant case by reason of the fact that the donees commenced to enjoy the gift property immediately, and that the donees were named exclusively.

In *Commissioner v. Krebs,* 90 Fed. (2d) 880, decided June 4, 1937, in a trust of strong similarity to the one at bar, and after consideration of the Congressional Committee Standard, the Third Circuit Court said:

> "We are further of the opinion that tested by the nature of the gifts to the *cestui que* trusts, the donor was entitled to the deduction. The donees were named, the respective values of the gifts to them were ascertainable, and they were given the use of the income and of the unexpended accumulated income without an intervening estate even though physical possession was postponed."

The Board applied the standard of the Congressional report in the instant case and found that "gifts of the remainder interests, that is, the corpus of the trust, were gifts of future interests." [R. 36.] Therein, petitioner contends the Board erred.

3. The Restatement of the Law of Property Furnishes a Further Standard by Which May be Determined the Nature of Property Interests Subject to Trust.

The *Restatement of the Law of Property*, Vol. 2, Sec. 153, page 520, says a present interest in property which is the subject matter of a trust is any interest which includes

> "either the right to the immediate beneficial enjoyment of the proceeds of the trust; or the right of the trustee forthwith to have the control and management of the affected thing pursuant to the provisions of the trust."

The above test is repeatedly used by the courts in determining whether the donee beneficiaries have a present interest for gift tax exclusion purposes. Under this test it is only necessary for the donees to have the immediate right to enjoy all the income from the trust in order to qualify their interests as present interests in property. This is equivalent to saying the beneficiary should immediately have all the fruit from the tree or all the milk from the cow to qualify his interest as a present interest. It does not say he necessarily has to have the right to use the tree for firewood, or cut up the cow for steaks. The right of alienation is unimportant (*Welch, et al. v. Paine*, 120 Fed. (2d) 141, 143):

> "Nor is it important, if true, that the interest of the minor beneficiary may in some way be available to his creditors."

The property must afford a benefit to the beneficiaries, it must be dedicated to that purpose, and the benefit must be available to the beneficiaries as an absolute right. It is

not necessary in addition thereto that the donees can destroy the property and defeat the purpose of a beneficent donor.

The right to the immediate enjoyment of the proceeds of the gift in a beneficial form is all that is required, preferably in the normal and beneficial form in which the donor enjoyed the property, and wished the donees to benefit therefrom.

Applying this test to a gift in trust where the income was to become a part of the principal, and accumulated until the donee beneficiaries were twenty-one years old, the Court, in *Welch v. Paine* (*supra*), held the donees' interests were future interests in property, saying:

> "As applied to the interests of a beneficiary under a trust, a 'future interest' is used by way of contrast to a 'present interest', which is characterized by the Restatement (*supra*), Sec. 153, as 'the right to the immediate beneficial enjoyment of the proceeds of the trust.' The minor beneficiaries in the present case clearly have not the right to the immediate beneficial enjoyment of the trust income."

In the case at bar, using this test (cited by petitioner in her brief below) the Board should have concluded that the interests conveyed to the donees were present interests in property, inasmuch as the Board found the donees were entitled to the income immediately within the year, to-wit:

> "The beneficiaries here had the right to the present enjoyment of the income." [R. 35.]

In failing to so conclude that donees had a present interest in the light of this test, the Board erred.

4. **The Board Did Not Follow the Rulings of the Court.**

The matter of construing the character of a gift for the purpose of gift tax exclusion has been before District Courts, Circuit Courts of Appeal, and the Supreme Court. Several of these cases are reviewed herewith.

A. In the matter of *U. S. v. Arthur Pelzer,* 312 U. S. 399, decided March 3, 1941, the Supreme Court had before it a trust designated the 1932 Pelzer Trust, in which the donor, a grandfather, conveyed property in trust for the benefit of eight named grandchildren, and any other after-born grandchildren. The income from the property in trust was to be accumulated for a period of ten years after the transfer of the gift. After the ten year period had elapsed, such living grandchildren as had attained the age of twenty-one years were entitled to share in the annual income from the then property in trust. The property in trust was to be distributed *per stirpes* twenty-one years after the death of the last named grandchild. The Court under these circumstances held that the property interests received by the donees were future interests in property.

The Court, in the *Pelzer* case (*supra*), settled several broad principles for the determination of the present or future interest character of the gift. First, that local or state definitions of the term "future interest in property" have no controlling effect as that term is used in the Federal Gift Tax Act; second, that the regulations issued by the Commissioner construing Section 504(b) are properly interpretive of such section and carried out the Congressional intent as indicated by the Committee Reports; third, that the Congressional Committee Report establishes a standard by which the character of a gift might be judged; and fourth, that the character of the gift is to be

determined from what the donee receives as a property interest.

It is apparent from the language used by the Court in the *Pelzer* case (*supra*), that if the beneficiaries in a trust have the right to the present enjoyment of the income thereof, that it would conclude the beneficiaries have a present interest in the gift property. There is no hint or suggestion in the *Pelzer* case (*supra*), that the same gift to the same person could at one and the same time be a present interest and a future interest in property. Neither the Supreme Court, nor any other Court, has assigned such a dual character to a gift to either one donee or one class of donees. Particular significance must be attached to the concluding words of the Court in the *Pelzer* decision, to-wit:

> "We have no occasion to consider the definition of future interests in other respects than those presented in the present case."

The Board of Tax Appeals in the instant case did not follow the decision of the Supreme Court, and erred in that it did not hold the gift to be a present interest in property. Petitioner's gift in the year 1937 meets every standard of a present interest in property as set forth in the *Pelzer* case (*supra*).

B. In the matter of *Commissioner of Internal Revenue v. Krebs*, 90 Fed. (2d) 880, decided June 4, 1937, the donor made a gift of property in trust to his three named children. The trustee was directed to use the income from property in the trust for the support and education of the donees until they reached the age of twenty-five, and to pay any unexpended income to the donees

directly. The Court there held that the gift was a present interest in property for the purpose of gift tax exclusion. The Court said (*Commissioner of Internal Revenue v. Krebs*, 90 Fed. (2d) at 881):

> "We are further of the opinion that tested by the nature of the gifts to the *cestui que* trusts, the donor was entitled to the deduction. The donees were named, the respective values of the gifts to them were ascertainable, and they were given the use of the income and of the unexpended accumulated income without an intervening estate even though physical possession was postponed."

The determination of the Third Circuit Court of Appeals in this case was entirely consistent with the standards set down by the Supreme Court in the *Pelzer* case (*supra*), almost four years later. The trust in the *Krebs* case (*supra*), in so far as it is described in the decision, bears marked similarity to the trust in the instant case. In each case the income from the property was to be distributed to the donees and they therefore enjoyed the property *in presentae*. It is apparent that the Board did not follow the ruling of the Court in *Commissioner v. Krebs* (*supra*).

C. In the matter of *Noyes v. Hassett,* 20 Fed. Sup. 31, decided July 13. 1937, the donor made gifts of property in trust to four named children, each trust being separate. The trustees were directed to pay the net income from the property in trust to each donee in quarterly installments for life. The trustees were enpowered to accumulate income in their discretion or to make payments from principal but the child could not demand such payments. Each child had a power of appointment. The Court held that

the gift had the character of a present interest in property.

The decision in *Noyes v. Hassett* is likewise consistent with the determination of the Supreme Court in *U. S. v. Pelzer* (*supra*), decided almost four years later. The donee had the right to the immediate beneficial enjoyment of the proceeds of the trust which furnished the necessary element to qualify the donee's interest as a present interest in property.

The donees in the instant case had the same right to the present enjoyment of the property transferred and their interests likewise qualify as present interests in property.

The Board did not follow the ruling of the Court in this case.

D. In the matter of *Welch v. Paine*, 120 Fed. (2d) 141, decided June 3, 1941, the donor, a father, made gifts of property in trust for the sole benefit of named minor children. The trust required the income to become part of the principal and to be accumulated until the beneficiaries reached the age of twenty-one. At that age, each beneficiary was to receive his interest in the trust, free from the trust. The trustee could advance in his discretion sums for the education of the beneficiaries out of their respective shares. The Court held that such gifts were gifts of future interests, stating, at page 143 (120 Fed. (2d) 141):

> "Here both possession of the corpus and enjoyment of the income are postponed; . . . The minor beneficiaries in the present case clearly have not the right to the immediate enjoyment of the trust income."

The First Circuit Court, citing *U. S. v. Pelzer* (*supra*), in its use of the above language "the minor beneficiaries in the present case clearly have not the right to the immediate beneficial enjoyment of the trust income" indicated clearly that under the standards set out in the *Pelzer* case, the critical test is the right to the immediate beneficial enjoyment of the trust income.

It is evident in the instant case that the Board of Tax Appeals has interpreted *U. S. v. Pelzer* (*supra*) in a different manner than the First Circuit Court of Appeals.

E. In the matter of *Paine v. Welch*, 42 Fed. Supp. 348, decided December 12, 1941, the donor made gifts of property in trust to her eighteen named grandchildren. In addition, the donee clause included after-born grandchildren. Trustees, in their discretion, could distribute any part of the principal or income. Upon death, each donee's share was to be paid to his estate. The Massachusetts District Court there held that the gifts were present interests in property. This decision is subsequent to *U. S. v. Arthur Pelzer* (*supra*), and is consistent with the standards therein set forth. Here the distribution of income was discretionary with the trustees and the final dissolution of the trust as to a donee was not required until the death of such donee. It is very apparent that neither the District Court, nor the courts in the previously discussed cases, considered that to qualify the interest as a present interest in property the donee had to have

such an immediate physical possession of the property that he could destroy it and defeat the beneficent purposes of the donor. It was sufficient if he had "the right to the immediate beneficial enjoyment of the proceeds of the trust." (*Welch, et al. v. Paine,* 120 Fed. (2d) 141, at 143.)

It is interesting to note that the Board of Tax Appeals promulgated its opinion in the instant case (*Fisher v. Commissioner*), December 9, 1941, to-wit, three days prior to the decision of the Massachusetts District Court in *Paine v. Welch,* (42 Fed. Supp. 348).

The Board does not agree with the Court that "the right to the immediate beneficial enjoyment of the proceeds of the trust" is sufficient to qualify the donee's interest as a present interest in property.

F. In the matter of *Commissioner of Internal Revenue v. Brandegee,* 123 Fed. (2d) 58, decided October 30, 1941, the donor made gifts in trust to her four living children. The terms of the trust permitted the trustees to acquire property subject to encumbrances, and provided that the donee beneficiaries would not be entitled to the net income while any such encumbrances remained unpaid. The Court held that property interests acquired by the donees were future interests inasmuch as the trustees had the power to withhold all income from the beneficiaries while any such encumbrances assumed by the trust re-

mained unpaid. In discussing the nature of present interests, the First Circuit Court of Appeals in this case states:

> "In the foregoing discussion we have assumed that the gift of an immediate life interest in income is to be regarded as a present interest, and we so hold."

It is apparent that the views of the First Circuit Court of Appeals do not conform to the views of the Board in that the Board holds that physical possession is the essential quality of a present interest in property.

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In summation it may be stated that the courts have uniformly established the simple rule that a gift is either a present interest or a future interest in property, depending upon whether the donees immediately enjoy the income from the gift property as a matter of right, and upon whether the donees could be deprived of such right of enjoyment during their natural lives. Possession of the corpus of trust property in the donee is not necessary as long as the donee had the right to all the income.

Here in the instant case the donees had the right to enjoy the income for their natural lives since the trustee was required to distribute the income to them until they were twenty-five years old, and thereafter the same donees had to receive the income from the property since the property itself was then distributed to them free of the trust. There were no remaindermen as the Board erroneously concludes in its opinion. [R. 36.]

II.

If the Present Interest in the Gift Property Is Solely the Donees' Right to Receive the Income the Value of Such Present Interest Should be Based Upon the Entire Period for Which Such Income Will be Received.

The petitioner argues, in the alternative, that if this Court upholds the Board of Tax Appeals to the effect that petitioner's gift in the year 1937 to her six named grandchildren is a gift of a present interest in property, merely to the extent that the donees have a right to the enjoyment of the income therefrom, that then, and in that case, the value of such present interest should be based upon the entire period during which the donees will receive such income. Under the opinion of the Board, the value of this right to receive the income is computed only on the short period the property remained in trust.

The Board of Tax Appeals supports its decision in the present case by citing its own decisions in *J. Willis Gardner,* 41 B. T. A. 679; *Leopold E. Block,* 41 B. T. A. 830; and, *Edith Pulitzer Moore,* 40 B. T. A. 1019.

An examination of the *Leopold E. Block* case (*supra*), decided April 12, 1940, by the Board, discloses a vastly different factual situation from the instant case. In the *Leopold E. Block* case (*supra*), the trustor, a husband and father, made a gift of property in trust with the provision in said trust that all net income would be distributed to his wife for her life. After the death of the wife (life

beneficiary), the income was to go to the descendants of the trustor, if the trustor was still living. When both the trustor and his wife were deceased, the corpus of the trust was to be distributed to the trustor's descendants. The Board held that the right of the wife to receive the income for life was a present interest, and that the rights of the descendants of trustor to receive the income or corpus as remaindermen were future interests in property. Here we have the typical life tenant and remainderman gift—two donees having adverse interests. The formula of the Board was made to fit this situation. Definitely the life tenant would have a present interest in property, and definitely the enjoyment of the property by the remaindermen, entirely different persons with adverse interests, would be postponed until the death of the life tenant. They had no enjoyment of the proceeds of the gift until the life beneficiary interest had ceased. Their interest was a future interest in property.

An examination of the *J. Willis Gardner* case (*supra*), decided March 29, 1940, discloses in the trust referred to that the donor made a gift of property to his nephew in trust. The donee was to receive the income from the property for twenty-five years, or for the period of his natural life, whichever was the shorter. If the donee was alive twenty-five years from the date of the gift, the property was to be distributed to him free of the trust. Otherwise, the property was to go to his heirs at law. The Board held that the value of the donee's present interest in the gift property was restricted to the right to receive the income for twenty-five years. The Board's holding in this case is wrong, for it is contrary to the rules adopted by the Courts. It does not strengthen the

Board's conclusion in petitioner's case by the citation thereof, since the Board's ruling has not been reviewed by the Courts. In both this case, *J. Willis Gardner* (*supra*), and the *Leopold E. Block case* (*supra*), the Board supports its decision by way of precedent by citing its previous holding in *Edith Pulitzer Moore* (*supra*).

An examination of *Edith Pulitzer Moore* (*supra*), decided December 5, 1939, discloses that the donor, a wife and mother, made a gift of property in trust with the provision that all the net income was to be paid to her husband in convenient installments during his life. After the death of her husband, the property was to be held in trust for the benefit of three sons, in a designated order of preference. The Board member who wrote the decision described the gift as "a gift in trust for A for life, and the remainder to B if he survives A." The Board held that the interests created by the trusts succeeding the death of the husband were future interests, while the gift to the husband of the right to receive the income was a present interest in property. Here again there were definitely adverse interests of a life tenant and remaindermen. The enjoyment of the property on the part of the remaindermen was definitely postponed to the death of the life tenant. It was in the *Edith Pulitzer Moore* case (*supra*) that the Board developed its formula for prorating the gift partly as a present interest in property and partly as a future interest in property. There, however, the present interest and the future interests were owned by distinctly different donees, each having adverse interests to the other. The formula of the Board fits such a case. The formula, however, is not a ready-made suit that can be put on every gift case. It needs sub-

stantial altering if it is to be made to fit the various types of gifts that arise. It is not possible by means of this formula to create adverse interests where none exist. For example, in the instant case, the petitioner's donees, as recipients of the income of the property, had no adverse interests to themselves as recipients of the corpus at the age of twenty-five years. They continued to receive the income from the property after they reached the age of twenty-five years, as well as before. The plain, simple fact is, that under the terms of the gift, the petitioner's donees had to receive the income from the property for life.

By way of further illustration that the Board cannot ignore the substance of a gift, let us suppose that a donor had made a gift of property in trust to his father, age ninety at the time of the gift, with a direction that the income from said property in trust be paid to the donee until he reached the age of one hundred twenty-five years. Very evidently the Board should disregard the mere formal words of the trust, and should restrict the present interest to the right to receive the income for the life of the donee. It should examine the reality of a gift if it is to apply its formula. As frequently stated in matters of taxation by the Courts, the collection of taxes cannot be dependent upon legal niceties or legal fictions. Tax laws have to be given a practical effect in order to accomplish their purpose.

U. S. v. Kirby Lumber Co., 284 U. S. 1.

The ready-made formula adopted by the Board to fit all cases of this type assumes in the instant case that petitioner's donees will die as they reach the age of twenty-five and that they, as such donees, will no longer receive the income from the property. This is a plain disregard of the fact, substance and reality of the property interests acquired by the donees from the donor. The Board has here created a pure legal fiction, comparable to the old legal fictions of common law, to-wit, the case must fit the writ, instead of the writ fitting the case.

Very plainly in the instant case the donor-petitioner, in making her gift in the year 1937 was not concerned with trusts, or interests in trusts as such. Her purpose was to convey the property to the donee grandchildren, so that they, and none other than they, would receive the property and all the benefits therefrom. The trust enters into the gift as a temporary custodianship for the period of a few years of financial incompetency on the part of the donees. Its purpose was solely to protect the donees during that period of financial incompetency. Plainly there was no period in the entire lives of the donees subsequent to the gift when they would not receive and enjoy the income from the property. There were no remaindermen or "remainder interests" as the ~~Court~~ Board states in its opinion. There was only one donee interest, and that was the interest of the petitioner's primary donees. There were no secondary donees.

Conclusion.

It is submitted, therefore, that the Board erred in concluding that the value of the present interests in the gift property was the right to receive the income until the donees became twenty-five years of age. It should have concluded that the donees had the right to receive the income from said property for the rest of their lives.

It is further submitted that if the Board followed the simple rules for determining present interests as set down by the Courts, it should have decided that the property interests acquired by the donees in the instant case from their donor, in the year 1937, were entirely present interests in property, inasmuch as the donees' interests in such gift meet every standard set down by the Courts in the determination of a present interest in property for the purpose of gift tax exclusion. They received the immediate enjoyment of the proceeds of the gift, the value of the property was ascertainable, and the number of donees was ascertainable.

It is therefore urged that the Board of Tax Appeals improperly applied the law to the facts found in this case, and that it should have found that there was no deficiency in petitioner's gift taxes for the year 1937.

Respectfully submitted,

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